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FISCAL IMPACT REPORT

ORIGINAL DATE 1/23/07

SPONSOR Robinson LAST UPDATED _____ HB _____

SHORT TITLE Military Pension Income Tax Exemption SB 43

ANALYST Francis

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Non-Rec	Fund Affected
FY07	FY08	FY09		
(9,850.0)	(19,700.0)	(19,700.0)	Recurring	General Fund

(Parenthesis () Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files
Taxation and Revenue Department

Responses Received From
Taxation and Revenue Department (TRD)
Veterans Service Commission (VSC)

SUMMARY

Senate Bill 43 exempts the military pension of any person retired from the US armed forces and who served at least 90 consecutive days on active duty or their spouse. The exemption is for pension income received on or after January 1, 2007.

FISCAL IMPLICATIONS

According to TRD (who uses data from Military.Com, a military service resources website), there are estimated to be 22,000 retirees in New Mexico in 2006 receiving an average of \$21,000 per year in payments from their pension. The exemption for the retirees would reduce personal income tax collections by \$19.7 million per year. Assuming tax years break evenly over fiscal years, the FY07 reduction in taxes is \$9.9 million and \$19.7 million in FY07 and subsequent years.

SIGNIFICANT ISSUES

There are also economic “feedback” impacts that are not captured in the fiscal impact analysis. Military personnel make a significant contribution to New Mexico’s economy while they are stationed here and encouraging them to retire in New Mexico is an important economic development goal. A 2005 New Mexico First Townhall report (NM Townhall #33) indicated that 12 jobs are supported by every million dollars of federal retirement payments (both civilian and military) in New Mexico. That means that military retirement spending in New Mexico supports over 4,600 jobs in NM.

The amount that would be available due to the proposed exemption does not necessarily share the properties of retirement spending as a whole since the savings from the exemption would be considered marginal income. If it is more likely to be saved than spent, New Mexico would not enjoy any benefit from the current retirees. To the extent that more people retire in New Mexico due to the exemption, New Mexico will receive the benefit of all of their spending. It is uncertain whether the spending of the retirees (current and newly arrived) would offset the foregone expenditure of the state government due to the lower revenues.

TRD notes:

- Individuals with incomes and other circumstances similar the military retirees receiving the proposed exemption are likely to view it as unfair, especially when they compete with the retirees for jobs, and when the retirees have relatively high incomes. According to the “military.com” website (<http://usmilitary.about.com/>), military retirement pay can be over \$9,000 monthly for high-ranking officers retiring in 2004.
- By reducing state tax obligations, the proposed measure would tend to increase federal tax liability because state tax obligations are deductible against federal liability for taxpayers who itemize. Hence the net taxpayer benefit would be less than the \$565 per claimant mentioned above. The \$565 in state tax savings would, for example, be reduced to \$452 ($\$565 \times .8$) for a taxpayer in the 20% federal tax bracket.

TRD has prepared a summary of legislation and comparisons with other states and is included as an appendix.

The Veterans Service Commission (VSC) reports that there is a significant legal issue. In the case, *Davis v. Michigan*, it was argued that exempting the pensions from one class of government employees (in this case, state employees) without extending this exemption to all government retirement (including federal employees) was exclusionary and thus unconstitutional. VSC feels that this bill will raise constitutional issues and likely be the subject of litigation.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

House Bill 368 is similar but exempts the earned income of military retirees up to \$50 thousand rather than the retirement benefits.

TECHNICAL ISSUES

TRD notes that the language does not include surviving spouses receiving military pension benefits and should be included if that was intended. This seems to be the suggestion by Section 1.B which refers to a spouse but does not indicate a surviving spouse.

ADMINISTRATIVE IMPACTS

TRD reports that the administrative impact would be relatively minor and would not require additional resources.

ALTERNATIVES

To address TRD's note above regarding high ranking officers, the exemption could be written with a phase-out at higher income levels.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Military retirees' pensions will still be subject to NM personal income tax.

NF/csd

Appendix: Present law treatment of military retirement income -- Source: Taxation and Revenue Department

Federal tax treatment of military retirement benefits:

Military pension income is treated as taxable income for federal income tax purposes. An exclusion is provided for survivor annuity payments. Veteran’s benefits are excluded from income tax.

New Mexico Statutes:

New Mexico statutes follow federal law in the treatment of military retirement income. Persons over 65 years of age are allowed an exemption from taxable income of \$8,000 per person. This exemption is reduced for taxpayers with adjusted gross income of more than \$15,000 (\$30,000 married) so that no exemption is available if adjusted gross income is more than \$25,500 (\$51,000 married).

Other states’ tax treatment of military retirement income:

Most states with a personal income tax allow some form of exclusion for retirement income, defined as government pension payments, Social Security, Railroad Retirement, private pension plans and public or private deferred compensation plans. Two purposes are cited for these provisions: to protect the income of retired persons and to encourage retired persons to re-locate or to remain in the state.

The U.S. Supreme Court has ruled that states may not discriminate against federal civil service or military pensions by providing better treatment of state pensions than is provided for federal pensions. However, there is no federal impediment to a state providing better treatment for public pensions than is provided for private pensions.

The following table summarizes the treatment of military pensions by the 42 states that have a broad-based personal income tax. Of the 42 states, all but 7 provide some form of exclusion for military pensions. In most cases, this relief is also provided for federal civilian pensions, state and local government pensions and for Social Security income. Only 2 states (Connecticut and New Jersey) provide relief that is targeted uniquely at military pensions.

Description:	Number of States with Provision:	Notes:
Full exclusion	12	AB, HI, IL, KS, LA, MA, MI, MS, NJ, NY, PA, WI
Capped dollar amount	7	AZ, AR, KY, ME, NC, ND, WV
Capped amount and age threshold	10	CO, DE, DC, GA, ID, IN, IA, MD, SC, VA
Percentage of military pension	1	CT
Amount subject to income level	3	MO, MT, OK
No specific exclusion<1>	7	MN, CA, NE, NM, RI, UT, VT
Tax credits	2	OH, OR
Total	42	